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NOTES

THE TAXABILITY OF SCHOLARSHIPS AND FELLOWSHIP GRANTS: A STUDENT GUIDE

I. INTRODUCTION

The recent announcement¹ of the Internal Revenue Service seems to indicate a shift in emphasis in the determination of the taxability of amounts received as scholarships and fellowship grants. In the light of this announcement, what is the current tax status of a scholarship and a fellowship grant? Under what conditions is such an award to be excluded from gross income? When is it an includible item? Though these questions have not been before the Supreme Court, touchstones can be found in the 1954 Internal Revenue Code, the Regulations which accompany it, Revenue Rulings, and case law. What are these guidelines? What facts and factors are considered by the Service in its application of these guides? What is the practical effect of the exclusion or inclusion of such an amount? The purpose of this note is to provide the recipients of such grants with an informative guide of the tax consequences.

II. TAXATION OF SCHOLARSHIPS AND FELLOWSHIP GRANTS PRIOR TO THE 1954 CODE

Prior to the enactment of the Internal Revenue Code of 1954, there was no statutory provision specifically covering the income tax treatment of amounts received as scholarships and fellowship grants. The typical approach was to determine whether or not the amounts so received fell within the statutory definition of gross income. Taxation depended upon whether or not the amounts received were intended as compensation for services rendered; if so, they were taxed; if not, they were excluded as gifts.² Thus the test was whether a grant was more properly classifiable as "compensation" or as a "gift."³

III. GENERAL RULE UNDER THE 1954 CODE

A. STATEMENT OF THE RULE.

In section 117 of the 1954 Code, Congress legislated specifically with respect to scholarships and fellowship grants. This section generally provides that amounts received as fellowship grants,⁴ and as scholarships⁵ at an educational institution which, under normal circumstances, maintains both a regular faculty and curriculum, while having a regularly organized body of students in attendance,⁶ are not to be included in the recipient's gross income. While primary and secondary schools, colleges, universities, normal schools, technical schools, nursing schools,⁷ and similar institutions are within the ambit of the Code's definition of an "educational institution," noneducational institutions, on-the-job training, correspondence schools, night schools, and the like are not.⁸

1. Tax Treatment of Amounts Not Excluded.

As an exclusionary provision, section 117 must be applied in conformity with

1 T.I.R. 482, 25 INT. REV. BULL. 25 (1963).

2 See George Winchester Stone, Jr., 23 TC 254 (1954); *Ti Li Loo*, 22 TC 220 (1954); *Ephraim Banks*, 17 TC 1386 (1952).

3 I.T. 4056, 2 CUM. BULL. 8 (1951) provided that "The amount of a grant or fellowship award is included in gross income unless it can be established that such amount is a gift."

4 INT. REV. CODE OF 1954, § 117(a)(1)(B). See Rev. Rul. 72, 1960-1 CUM. BULL. 44 (amounts awarded by Russell Sage Foundation to qualified sociologists); Rev. Rul. 370, 1957-2 CUM. BULL. 105 (awards to students enrolled in advanced courses of training for professional nurses).

5 INT. REV. CODE OF 1954 § 117(a)(1)(A).

6 *Id.* § 151(e)(4). See also, Rev. Rul. 484, 1957-2 CUM. BULL. 113 (institute giving specialized training in conjunction with business enterprise, qualified as educational institution).

7 Rev. Rul. 338, 1958-2 CUM. BULL. 54.

8 Treas. Reg. § 1.151-3(c) (1956).

the general rule of section 61.⁹ That section includes in gross income all items not otherwise specifically excluded. Therefore, since section 117 is an exception to section 61, whenever the amount received by a student fails to qualify for an exclusion as a scholarship or fellowship grant, or exceeds the exclusion limitations,¹⁰ it is included in his gross income.¹¹

2. Exclusivity of the Rule of Section 117.

The treatment of amounts received as a scholarship or fellowship grant is controlled solely by section 117. Accordingly, to the extent that a scholarship or a fellowship grant exceeds the limitations of section 117 it is includible in the gross income of the recipient notwithstanding the provisions of section 102 relating to the exclusion from gross income of gifts, or section 74(b) relating to the exclusion from gross income of certain prizes and awards, or section 1401, relating to the tax on self-employment income.¹² Similarly, even if the prize given in a contest is a scholarship, the amount will not be taxable if it qualifies for exclusion under section 117, despite the fact that it would be a taxable prize under the rules of section 74.¹³

B. GENERAL LIMITATIONS.

In prescribing limitations upon the general rule, section 117 differentiates between individuals who are candidates for degrees, and those who are nondegree candidates.

1. Degree Candidates.

A "candidate for a degree" is defined in the Regulations as follows:

[A]n individual, whether an undergraduate or a graduate, who is pursuing studies or conducting research to meet the requirements for an academic or professional degree conferred by colleges or universities. It is not essential that such study or research be pursued or conducted at an educational institution which confers such degrees if the purpose thereof is to meet the requirements for a degree of a college or university which does confer such degrees. A student who receives a scholarship for study at a secondary school or other educational institution is considered to be a "candidate for a degree."¹⁴

In the case of such an individual the exclusionary rule does not apply to that portion of any amount received which represents payment¹⁵ for teaching, research, or other services in the nature of part-time employment required as a condition to receiving the scholarship or the fellowship grant.¹⁶ This limitation does not apply, however, if such duties are required of all candidates — whether or not they are recipients of scholarships or fellowship grants — for a particular degree as a condition to receiving that degree.¹⁷ The fact that the individual is required to furnish periodic reports to the grantor of the scholarship or fellowship grant for the purpose of keeping the grantor informed as to his general progress is not deemed to constitute performance of services in the nature of part-time employment.¹⁸

⁹ INT. REV. CODE OF 1954, § 61(a).

¹⁰ See note 23 *infra* and accompanying text.

¹¹ See Rev. Rul. 522, 1957-2 CUM. BULL. 50 (amounts received by theologians from parish congregation). The amounts may still be exempt from taxation, however, if the student is studying abroad and receiving his earned income from sources without the United States, if he fulfills the requirements of section 911 of the Code.

¹² Treas. Reg. § 1.117-1(a) (1956). See also, Rev. Rul. 378, 1960-2 CUM. BULL. 38.

¹³ Rev. Rul. 80, 1959-1 CUM. BULL. 39; Clarence Peiss, § 40.13 P-H TC.

¹⁴ Treas. Reg. § 1.117(e) (1956).

¹⁵ Id. § 1.117-2(a)(1) (1956). Payments for such part-time employment are included in the gross income of the recipient in an amount determined by reference to the rate of compensation ordinarily paid for similar services performed by an individual who is not the recipient of a scholarship or a fellowship grant.

¹⁶ INT. REV. CODE OF 1954, § 117(b)(1).

¹⁷ *Ibid.* Treas. Reg. § 1.117-2(a)(2) (1956).

¹⁸ Treas. Reg. § 1.117-2(a)(1) (1956).

2. Nondegree Candidates.

Conditions for Exclusion. The exclusion for individuals who are not candidates for a degree was designed primarily for those receiving grants from charitable, scientific or educational institutions in order to carry out research or other projects. The exclusion is available only if the grantor of the scholarship or fellowship grant is one of the following: a tax-exempt organization described in section 501;¹⁹ a foreign government; an international organization,²⁰ or a binational or multinational educational and cultural foundation; or the United States, or a state, or any instrumentality or agency thereof.²¹

Questions sometimes arise as to who is the grantor of the fellowship. A recent case²² is typical. A taxpayer was receiving a monthly stipend while attending Oak Ridge School of Reactor Technology, which was operated by a nongovernmental corporation under a contract with the Atomic Energy Commission. The tax court concluded that there was not a sufficient showing that the corporation was an agency of the United States. Therefore, the stipend paid by it could not qualify for an exclusion from gross income.

Extent of Exclusion. The amount of the exclusion in any taxable year is limited to an amount equal to \$300 times the number of months for which the recipient received amounts under the scholarship or fellowship grant during the taxable year.²³ Anything in excess of that amount is taxable income.²⁴ Often the grantors may increase the value of the grant where the recipient supports a family, but there is no additional exclusion for amounts received as an allowance for dependents. Therefore, even though an allowance for dependents is taken into account by the grantor in determining the amount of the grant, the total amount received by the recipient is considered as the amount of the grant and must therefore be included in gross income to the extent that it exceeds the limitations of the exclusion.²⁵ In addition to the amount limitation, the exclusion is also limited in terms of time to a period of 36 months.²⁶ After the recipient has been entitled to the exclusion for that period, whether or not the months are consecutive, amounts received as a scholarship or fellowship grant are fully taxable. The exclusion period may be exhausted even though the taxpayer did not make use of the maximum exclusion in any of the 36 months.²⁷

C. DEFINITIONS OF "SCHOLARSHIP" AND "FELLOWSHIP GRANT."

Although the Code does not attempt to define a "scholarship" or "fellowship grant," both terms are defined in the Regulations. A scholarship is an amount paid to a student, whether an undergraduate or a graduate, to aid him in pursuing his studies,²⁸ while a fellowship grant is an amount paid to an individual to aid him in

19 INT. REV. CODE OF 1954, § 501 enumerates a list of tax-exempt organizations. A sampling of the list includes corporations, a fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes.

20 REV. RUL. 19, 1963-1 CUM. BULL. 28 (NATO qualifies as an international organization).

21 INT. REV. CODE OF 1954, § 117(b)(2).

22 Norman R. Williamsen, Jr., 32 TC 154 (1959).

23 INT. REV. CODE OF 1954, § 117(b)(2). Sec. Rev. Rul. 378, 1960-2 CUM. BULL. 38.

24 INT. REV. CODE OF 1954, §§ 117(b)(2); 61(a). In the case of an individual who receives amounts from more than one scholarship or fellowship grant during the taxable year, the total amounts received in the taxable year are to be aggregated for the purpose of computing the amount which may be excludable from gross income for such taxable year. Treas. Reg. § 1.117-2(b)(2)(iii) (1956).

25 Rev. Rul. 554, 1955-2 CUM. BULL. 36.

26 INT. REV. CODE OF 1954, § 117(b)(2). See Rev. Rul. 81, 1959-1 CUM. BULL. 37. If the amounts are received from more than one scholarship or fellowship grant during the same month or months within the taxable year, the month or months are to be counted only once for purposes of determining the number of months for which the individual received those amounts under the scholarships or fellowship grants during the taxable year.

27 Treas. Reg. § 1.117-2(b)(2)(ii) (1956).

28 *Id.* § 1.117-3(a) (1956).

the pursuit of study or research.²⁹ Neither term includes amounts provided by an individual to aid a relative, friend, or other individual in pursuing his studies where the grantor is motivated by family or philanthropic considerations.³⁰ However, such amounts may be excludable from the gross income of the recipient as a gift under section 102.³¹

D. RESTRICTIONS UPON THE EXCLUSION.

The denomination of scholarships as excludable or includable has not been a source of great difficulty. Much of the uncertainty under section 117, however, has centered around the determination of what constitutes a fellowship grant. The problems have arisen not from the definition found in the Regulations,³² but from the restrictions placed upon this definition. First, there is no exclusion of amounts paid as compensation for services subject to the direction or supervision of the grantor.³³ Secondly, studies or research must not be primarily for the benefit of the grantor.³⁴ However, neither of these restrictions apply — thus qualifying the amount as a fellowship grant — if the primary purpose of the award is to further the pursuit of the education and training of the recipient in his individual capacity.³⁵ Thus, the "further the education and training" test is of crucial significance. In fact, many rulings and cases treat it as the controlling test,³⁶ ignoring the more general definition of a fellowship grant as an amount paid to an individual to aid him in his study or research. Indeed, the test prescribed by the definition of a fellowship grant — determining whether or not, in fact, a stipend does aid an individual in his study of research — often seems to be overlooked. In practice, it appears that the Internal Revenue Service is in reality reverting to the pre-1954 compensation-gift concepts in its application of the "further the education and training" test.³⁷ In so doing, the vitality and utility of section 117 are of course enervated. Furthermore, under the circumstances, any application of this pre-Code test would appear to be clearly contrary to the language of the Code and its legislative history,³⁸ which make it clear that amounts received as a scholarship or fellowship grant may be compensatory in character and yet still be excludable from gross income.³⁹ It would seem, therefore, that the thrust of the Service's inquiry is directed toward an examination of the grantor's purpose in making the award, concerning itself but transcendently with the recipient's necessity for receiving it. Realizing this and accepting the approach of the Service as a *fait accompli*, whether or not found to be objectionable, there are certain discernible tendencies to be noted.

29 *Id.* § 1.117-3(c) (1956).

30 *Supra* note 28.

31 INT. REV. CODE OF 1954, § 102; Rev. Rul. 66, 1961-1 CUM. BULL. 19.

32 *Supra* note 29.

33 Treas. Reg. § 1.117-4(c)(1) (1956).

34 *Id.* § 1.117-4(c)(2) (1956). See Rev. Rul. 118, 1959-1 CUM. BULL. 41 (graduate students, serving as VA staff assistants, constituted essential part of psychology services); Rev. Rul. 101, 1956-1 CUM. BULL. 89 (interns and resident doctors performed services of material benefit to trainer and received pay substantially the same as employees). See also Joseph D. Woddail, § 62,232 P-H Memo TC, *aff'd*, 321 F.2d 721 (CA 10th, 1963); *Ussery v. United States*, 296 F.2d 582 (CA 5th, 1961) (educational leave to public welfare department employee for purpose of improving efficiency of department).

35 Treas. Reg. § 1.117-4(c)(2) (1956). See Charles P. Ide, § 40.76 P-H TC; Lawrence Spruch, § 61,063 P-H Memo TC; Rev. Rul. 419, 1956-2 CUM. BULL. 112. Neither the fact that the recipient is required to furnish reports of his progress to the grantor, nor the fact that the results of his studies or research may be of some incidental benefit to the grantor is, of itself, considered to destroy the essential character of the amount as a scholarship or fellowship grant. Treas. Reg. § 1.117-4(c)(2) (1956). See Rev. Rul. 131, 1957-1 CUM. BULL. 75.

36 See, e.g., Frank Thomas Bachmura, 32 TC 1117 (1959).

37 See note 3 *supra* and accompanying text. See also N.Y.U. 19th INST. ON FED. TAX. 129, 139 (1961).

38 Sen. Rep. No. 1622, 83d Cong., 2d Sess. 17, 188 (1954); H. Rept. No. 1337, to accompany H.R. 8300 (Pub. L. 591), 83d Cong., 2d Sess. 16 (1954).

39 William Wells, § 40.8 P-H TC. See Chander P. Bhalla, 35 TC 13 (1960).

The rulings and decisions have generally been adverse to the taxpayer when his employer has been the payor of the alleged scholarship or fellowship grant. Thus, where the amounts received carry with them an appointment to an officially established position,⁴⁰ or an obligation to render future services,⁴¹ or are commensurate with salaries paid regular employees,⁴² they are included in the recipient's gross income.⁴³ Similarly, amounts received by an individual from a business enterprise employing him while he attended an institute maintained in conjunction with the employer were ruled to be additional taxable compensation to the employee.⁴⁴

If the taxpayer is regularly engaged in conducting research for his employer, and the employment relationship can be expected to continue indefinitely, the amount paid by the employer to support a research project is generally denied an exclusion. This of course is reasonable, for any other result would be tantamount to granting tax-free compensation to persons in particular types of work.⁴⁵ Hence, an amount paid by a college to a member of its teaching staff while on sabbatical leave to engage in research has been ruled to be taxable compensation.⁴⁶ On the other hand, when the employment relationship between the payor and the recipient is of a temporary nature, the tendency has been for the recipient to succeed in obtaining the benefit of exclusion. A common example of this tendency is found in the situation where an employer makes an award to a student whom he employs during the summer months. In a recent ruling an amount paid to a person who was just graduated from high school and worked for the employer for the summer qualified as a scholarship when it was paid to enable him to attend college and there was no obligation for him to render future services to the payor-employer.⁴⁷

When the payor of the grant has no previous employment relationship with the recipient, the tendency has been to permit the taxpayer the benefit of the exclusion. Thus, where a grant was made by a foundation to a student to enable him to complete the necessary research for his doctoral dissertation the exclusion was ruled applicable notwithstanding the fact that the foundation might derive some benefit from the research.⁴⁸ Another clear illustration of this tendency may be found in a recent ruling where, although the amounts paid by a college to a member of its teaching staff on sabbatical leave were ruled taxable, a similar amount received from a private foundation to support the same research was ruled to be a fellowship grant.⁴⁹ The case is even stronger for permitting the exclusion when the grantor holds no employment relationship to the recipient and the recipient is not yet fully trained in his field. Clearly the purpose of the award is then to educate and train the individual.⁵⁰ In this regard a comparison of two recent rulings is of particular interest. When the National Science Foundation made grants to high school and

40 Rev. Rul. 322, 1958-1 CUM. BULL. 59 (civil service employee of United States Government).

41 Rev. Rul. 403, 1958-2 CUM. BULL. 49 (benefits received under United States Navy's educational assistance program, the recipient to render the Navy services upon graduation). See also, Rev. Rul. 347, 1955-1 CUM. BULL. 21.

42 *Supra* note 22.

43 A notable exception to the tendency to rule against the taxpayer if the grantor is his regular employer occurred in the case of a research fellowship grant awarded by the National Institute of Health to a member of its staff. Rev. Rul. 179, 1958-1 CUM. BULL. 57

44 Rev. Rul. 484, 1957-2 CUM. BULL. 113.

45 See 1 MERTENS, LAW OF FEDERAL INCOME TAXATION § 7.42 (1962).

46 Rev. Rul. 222, 1958-1 CUM. BULL. 54.

47 Rev. Rul. 191, 1959-1 CUM. BULL. 40. See also Chander P. Bhalla, 35 TC 13 (1960) (research used as credit toward fulfilling research requirements for doctoral degree); Rev. Rul. 188, 1962-2 CUM. BULL. 42; Rev. Rul. 65, 1961-1 CUM. BULL. 19 (amounts received for study or research abroad, under Fulbright Act and United States Information and Educational Exchange Act of 1948).

48 Rev. Rul. 419, 1956-2 CUM. BULL. 112.

49 Rev. Rul. 222, 1958-1 CUM. BULL. 54. See also, Rev. Rul. 81, 1959-1 CUM. BULL. 37; Rev. Rul. 131, 1957-1 CUM. BULL. 75.

50 Rev. Rul. 76, 1958-1 CUM. BULL. 56.

college science and mathematics teachers to enable them to attend summer institutes in order "to improve their subject-matter knowledge and for intellectual stimulation" it was ruled that the grants were scholarships and fellowships for purposes of section 117.⁵¹ But when amounts were paid by the National Science Foundation to mathematics teachers to induce them to use experimental text material in their regular classes and to cooperate with a study group in evaluating the results, it was ruled that the amounts paid were compensation for services rendered and not fellowship grants.⁵²

A number of cases and rulings have involved persons not yet fully qualified in their field, but nevertheless capable of rendering services of some value while still being further trained themselves. Common examples involve interns, resident physicians, and student nurses. Under the tests found in the Regulations the issue is typically phrased as to whether the primary purpose is the rendering of services or the training of the individual.⁵³ In most of the rulings the Service has found the primary purpose to be the rendering of services and accordingly has held that the amount received by the taxpayer was taxable as compensation for services.

Many of the rulings and cases holding such trainee-employees taxable on amounts they have received have emphasized that these persons render services which must be performed for the charitable employer to carry out its function.⁵⁴ Other cases and rulings, however, have found that the amounts received by the trainee-employee were intended primarily for his self-improvement, and therefore qualified for exclusion.⁵⁵ Frequently considered was whether the training of these students involved the replacement of regular employees.⁵⁶ Also stressed was the fact that the performance of services is the only practical manner in which students can be trained.⁵⁷ Weighing these considerations in favor of excluding awards to graduate physicians participating in a program of training at a psychiatric institute founded for such purpose, a federal court has stated:

The education and training of those physicians goes beyond observation, but observation is not the only or necessarily the best means of learning. Those in charge of the administration of the Institute and the execution of its functions have determined upon a practical program for the instruction and training of physicians in psychiatry, including supervised exposure of the trainee to a wide variety of case problems in clinical settings, and to problems of communication of complex ideas, administration and hospital service. The defendant [Director of Internal Revenue] contends that pursuit of such a program by a physician at the Institute constitutes him, for tax purposes, an employee engaged in the performance of service. In effect, we are asked to set aside the judgment of qualified teachers in the field of psychiatry as to a proper and effective method of training and instruction. Under the facts presented, we decline to do so.⁵⁸

A comparison of these examples with the cases under the pre-1954 law seems to indicate quite clearly that there has been little change of focus. Indeed, it may be said that the value of section 117 lies not in having provided a solution to the

51 Rev. Rul. 498, 1958-2 CUM. BULL. 47.

52 Rev. Rul. 274, 1960-2 CUM. BULL. 39.

53 Treas. Reg. § 1.117-4(c) (1956).

54 See, e.g., Ethel M. Bonn, 34 TC 64 (1960) (resident physician rendered services essential to carrying out principal purpose of hospital which was to treat patients); Rev. Rul. 118, 1959-1 CUM. BULL. 41 (graduate students serving training period as junior staff members by providing psychology services); Rev. Rul. 386, 1957-2 CUM. BULL. 107 (interns and resident physicians); Rev. Rul. 127, 1957-1 CUM. BULL. 275 (scientific research project with grantor reserving patent rights); Rev. Rul. 101, 1956-1 CUM. BULL. 89 (interns and resident physicians).

55 Aileene Evans, 34 TC 720 (1960) (psychiatric nursing program); Rev. Rul. 130, 1960-1 CUM. BULL. 46 (grants for cancer research); Rev. Rul. 72, 1960-1 CUM. BULL. 44 (specialized training for sociologists, social psychologists, and anthropologists).

56 See, e.g., Rev. Rul. 560, 1957-2 CUM. BULL. 108.

57 See, e.g., Rev. Rul. 338, 1958-2 CUM. BULL. 54 (full time student nurses); Rev. Rul. 76, 1958-1 CUM. BULL. 56 (cardiovascular research).

58 *Wrobleski v. Bingler*, 161 F. Supp. 901, 904-05 (W.D. Pa. 1958).

problem but rather in its recognition that scholarships and fellowships are sufficiently unique in terms of their social function and in the framework in which they are employed to merit treatment separate from that accorded gifts and compensation. The real weakness of the section thus far lies in the fact that the meaning of this uniqueness has not been sufficiently recognized and articulated by the Service in its application of the section.

The recent announcement by the Service,⁵⁹ however, holds more than just a glimmer of hope for grant recipients. Hereafter the Service will dispose of cases which are substantially identical on their facts to the *Bhalla*⁶⁰ and *Spruch*⁶¹ cases in accordance with the decisions of the Tax Court in those cases. Prior to the *Bhalla* decision the Service had been quite ready to qualify "training grants" for the exclusion,⁶² while governmental and private "research grants" were generally considered to result in the receipt of taxable income. The rendition of required services, of course, disqualified a grant. But in *Bhalla* the court held exempt a "research grant" made to a candidate for a graduate degree upon the ground that the award constituted a fully exempt scholarship. The opinion is especially noteworthy because the question of taxability was examined from the point of view of the recipient, rather than from the point of view of the granting organization's intent. It did in fact, what the Code and Regulations purport to do in theory—it excluded from the recipient's gross income amounts paid "to aid the individual in his study or research." If the announcement will have the effect it seems to hold forth, and the Service adopts the position that stipends will be considered from the viewpoint of the recipient, the present distinction between "training grants" and "research grants" will topple and the use of such grants as a part of the educational process will be accorded deserved weight. It is important to note, however, that the Service stressed the fact that in both the *Bhalla* and *Spruch* cases equivalent research was required of all candidates for the same degree at each university.

E. EFFECT OF WITHHOLDING OF INCOME TAXES BY PAYOR.

The fact that the payor of a stipend withholds taxes on its disbursements is of little consequence in determining whether the grant is taxable compensation or an excludable grant. The payors of these stipends often withhold taxes. Their purpose is one of statutory compliance—a form of self-protection from the imposition of a penalty for the avoidance of tax payments. As was pointed out in *Bhalla*, by withholding income tax with respect to a stipend, the institution "... may well have acted with an abundance of caution, in order to safeguard itself against possible charges or penalties for failure to perform its duty in a field where the law was not clearly defined."⁶³ Therefore, the fact of tax withholding, alone, is inconclusive in any determination of whether a grant is entitled to the exclusionary rule of section 117.⁶⁴

F. FRINGE BENEFITS.

The general rule of section 117 excludes from the recipient's gross income not only the corpus of the scholarship or fellowship grant itself, but also excludes the value of contributed services and accommodations.⁶⁵ These include room, board, laundry service, and similar services or accommodations which are received by an individual as a part of the scholarship or fellowship grant.⁶⁶ In addition, the exclu-

59 T.I.R. 482, 25 INT. REV. BULL. 25 (1963).

60 Chander P. Bhalla, 35 TC 13 (1960).

61 Lawrence Spruch § 61.063 P-H Memo TC.

62 See, e.g., Rev. Rul. 76, 1958-1 CUM. BULL. 56; Rev. Rul. 370, 1957-2 CUM. BULL. 105.

63 *Supra* note 60 at 17.

64 See note 58 *supra*.

65 INT. REV. CODE OF 1954, § 117(a)(1).

66 Treas. Reg. § 1.117-3(d) (1956). See Rev. Rul. 338, 1958-2 CUM. BULL. 54.

sion includes any amount received to cover expenses for travel,⁶⁷ research, clerical help, or equipment which are incident to a scholarship or a fellowship grant that is excludable from gross income.⁶⁸ This allowance is excluded only to the extent that the amount received is specifically designated to cover expenses for travel, research, clerical help,⁶⁹ and to the extent that such amount is actually expended by the recipient.⁷⁰ The expenses must be incurred in order to effectuate the purpose for which the scholarship or fellowship grant was awarded.⁷¹ The portion of any amount received to cover expenses which is not actually expended must be returned to the grantor within the exclusion period. If not, it is included in the gross income of the recipient for the taxable year in which the exclusion period expires.⁷²

IV. EFFECT UPON AVAILABILITY OF DEPENDENCY DEDUCTION

Section 151 of the Code entitles the student-taxpayer to a personal exemption allowance for himself and his dependents.⁷³ This section⁷⁴ also allows the student's⁷⁵ parent to claim a dependency⁷⁶ exemption for his child provided he has furnished more than one-half of the support for the student for the taxable year, even though the income of the student for that year may be \$600 or more.⁷⁷ In such a case, there may be two exemptions claimed for the student: one on the parent's return, and one on the student's return. In determining whether the parent-taxpayer satisfies the support test, a special rule regarding scholarships applies. Amounts received as scholarships — including room, board, and other contributed services and accommodations — are disregarded in determining whether the parent-taxpayer furnished more than one-half the student's support.⁷⁸ Of course, if the scholarship fails to qualify for exclusion under section 117 and it is included in the student's gross income, it must be considered in determining whether the parent-taxpayer has contributed more than half of his child's support.⁷⁹

Even if the student is married, the parent-taxpayer is allowed a dependency deduction if the support test is met. Furthermore, the parent-taxpayer is allowed an exemption not only for his child but also for the members of his child's family

67 Travel expenses include meals and lodging while traveling and an allowance for travel of an individual's family. Treas. Reg. § 1.117-1(b)(1) (1956).

68 Treas. Reg. § 1.117-1(b)(1) (1956). If, however, only a portion of a scholarship or fellowship grant is excludable from gross income, because of the part-time employment limitation or because of the expiration of the 36 month period, only the amount received to cover expenses incident to the excludable portion is excludable from gross income.

69 *Id.* § 1.117-1(b)(2)(i) (1956).

70 INT. REV. CODE OF 1954, § 117(a)(2).

71 Treas. Reg. § 1.117-1(b)(1) (1956).

72 *Id.* § 1.117-1(3) (1956). See Rev. Rul. 222, 1958-1 CUM. BULL. 54.

73 INT. REV. CODE OF 1954, § 151(a).

74 *Id.* § 151(e)(1)(B).

75 "Student" is defined as an individual who during each of five calendar months during the calendar year in which the taxable year of the taxpayer begins, is a full-time student at an educational institution, or is pursuing a full-time course of on-farm training under the supervision of an accredited agent of an educational institution or of a State. INT. REV. CODE OF 1954, § 151(e)(4). The five calendar months need not be consecutive. Treas. Reg. § 1.151-3(b) (1956). Although school attendance exclusively at night does not constitute full-time attendance, full-time attendance at an educational institution may include attendance at night in connection with a full-time course of study. *Ibid.*

76 "Dependent" means any of an enumerated list of individuals (including son, daughter, and descendants of either; son-in-law, and daughter-in-law) who receive over half of their support from the taxpayer. INT. REV. CODE OF 1954, § 152(a).

77 Ordinarily, in order for a dependency deduction to be allowed a taxpayer, the dependent must have income of less than \$600. However, when the child of the taxpayer is a student, the dependency deduction is allowed irrespective of the dependent's income, so long as the parent contributes over one-half of his support. Treas. Reg. § 1.152-1(c) (1956).

78 INT. REV. CODE OF 1954, § 152(d). See Charles P. Ide, § 40.76 P-H TC; Rev. Rul. 338, 1958-2 CUM. BULL. 54.

79 See Rev. Rul. 355, 1959-2 CUM. BULL. 53; Rev. Rul. 403, 1958-2 CUM. BULL. 49; Rev. Rul. 347, 1955-1 CUM. BULL. 21.

if he contributes more than one-half of their support.⁸⁰ As with the unmarried student, the same dependency deductions may be allowed on the returns of both the student and the parent. The exemption is denied the parent only when the dependent child has filed a joint return with his spouse. Although the value of a scholarship is disregarded in order to determine whether the student received more than half his support from his parent, this special support test is limited to a son or daughter.⁸¹ Therefore, when the parent of the student claims a dependency deduction not only for the student himself, but also for members of the student's family, any portion of the grant which the recipient uses for support of his family must be considered as his contribution to their support in determining who furnished more than one-half of their support.⁸² Thus, a parent is entitled to a dependency deduction for the student's spouse and children only if, after taking into consideration any part of the stipend used by the recipient for his family's support, he furnished more than half of their support.⁸³ The parent is allowed these deductions, however, only if the spouse and children individually do not have gross income of \$600 or more.⁸⁴

V. CONCLUSION

In section 117 of the 1954 Code, Congress, by specifically providing a tax treatment for scholarships and fellowship grants apart from that accorded gifts and compensation, expressed a legislative cognizance of the uniqueness of these stipends in terms of their social function. Prior to the enactment of the Code, however, there was no separate recognition — and hence, no separate tax treatment — for scholarships and fellowship grants. Where uncertainty or controversy existed, resort was had to the "gift or compensation" test. Problems arose since this test lacked a clear-cut basis for determination. Enacted to resolve the problems of prior case law, section 117 afforded a reasonable basis for the solution of these problems. However, the section has not been permitted to function according to legislative intent. The Service has not utilized its opportunity because it has failed to alter its outlook on the nature of these problems. Rather than giving due weight to the essentially unique character of scholarships and fellowship grants themselves, and rather than viewing these awards from the position of the recipient, it has reverted chiefly to the pre-1954 touchstones by continuing to look at the amounts received from the point of view of the grantor. Such a focus stands in opposition to the language and policy of the Code, and its legislative history.⁸⁵ There is embodied in the Code no *carte blanche* mandate that all compensation be included in gross income.⁸⁶ Indeed, it is clear that amounts received as a scholarship or fellowship grant may be excluded notwithstanding the fact that they are compensable in character.⁸⁷ Therefore, a change in the outlook of the Service is impelled by the existence of section 117 and by the nature of these grants. Such a change can readily take the form of a recognition of the function of these payments. By adopting the position of the Tax Court in the *Bhalla* and *Spruch* cases, the recent announcement of the Service⁸⁸ has, at least impliedly, expressed a recognition of the desirability of a change in focus, consonant with the legislative policy of the 1954 Code. It remains to be seen, however, whether the revised applicable regulations promised by the Service⁸⁹ will embody this shift in emphasis.

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80 INT. REV. CODE OF 1954, § 152(a).

81 *Id.* § 152(d).

82 See, Rev. Rul. 53, 1961-1 CUM. BULL. 21.

83 INT. REV. CODE OF 1954, § 151(e).

84 See *supra* note 77.

85 Sen. Rep. No. 1622, 83d Cong., 2d Sess. 17, 188 (1954); H. Rept. No. 1337, to accompany H.R. 8300 (Pub. L. 591), 83d Cong., 2d Sess. 16 (1954).

86 See, e.g., INT. REV. CODE OF 1954, §§ 107; 119.

87 See William Wells, § 40.8 P-H TC.

88 T.I.R. 482, 25 INT. REV. BULL. 25 (1963).

89 *Ibid.*